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July 29, 2005

VIA ELECTRONIC FILING

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, N.W.
Washington, D.C. 20554

Re: WC Docket No. 05-25 & RM-10593, XO's Reply Comments

Dear Ms. Dortch:

Please find attached for filing in the above-referenced dockets, Reply Comments of XO Communications, Inc. on the Commission's Order and Notice of Proposed Rulemaking released January 31, 2005.

Please do not hesitate to contact me at (202) 887-1240 if you have any questions or concerns regarding this filing.

Sincerely,

Kimberly A. Scardino

DC01/SCARK/236367.1

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

REPLY COMMENTS OF XO COMMUNICATIONS, INC.

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I. INTRODUCTION AND SUMMARY

XO Communications, Inc. ("XO"), through counsel, submits these reply comments on the Federal Communications Commission's ("FCC" or "Commission") Order and Notice of Proposed Rulemaking ("NPRM") released January 31, 2005 in the above referenced dockets.[1] In its initial comments, XO demonstrated that the FCC's pricing flexibility triggers for special access are not adequate predictors of competition and are incapable of addressing the worsening problem of high special access rates. As other carriers also correctly pointed out, deregulation has not disciplined special access pricing. Rather, it has had the opposite effect: rates are higher and the Bell Operating Companies ("BOCs") are realizing monopolistic profit margins on special access services. Similar to other parties, XO urged the FCC to revoke pricing flexibility and immediately reinitialize special access rates at the FCC authorized 11.25% rate of return.

The BOCs and USTA tell a different story. They claim there is robust competition for special access services and that the FCC should abolish all special access regulation. According to them, they are not realizing higher rates of return on special access services like ARMIS reports reveal. They argue that ARMIS data is not reliable and should be ignored in this context. Instead, they argue that the FCC ought to take notice of all the alleged competition in the special access market and completely deregulate prices nationwide.

The BOCs' comments are misleading. Special access competition is not robust nationwide. Where competition does exist, it is largely from AT&T and MCI who are being purchased by the two largest BOCs, SBC and Verizon. Even with competition from AT&T and MCI, the BOCs have raised special access rates where pricing flexibility has been granted.

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1 *Special Access Rates for Price Cap Local Exchange Carriers, AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Order and Notice of Proposed Rulemaking, WC Docket No. 05-25 and RM-10593, FCC 05-18 (rel. January 31, 2005) ("*NRPM*").

While the BOCs are enjoying profits averaging over 50% for special access services, CLECs are struggling to stay alive. Now is certainly not the time to further deregulate special access pricing. To the contrary, the FCC should revoke pricing flexibility and immediately reinitialize special access rates at the FCC authorized 11.25% rate of return.

II. ARGUMENT

A. Competitors Are Forced to Rely on the ILECs for Special Access Service

The BOCs and USTA claim that there is robust competition for special access services and therefore the FCC should deregulate special access pricing nationwide. BellSouth calls its plan to completely deregulate special access in two years "conservative" while Verizon calls the FCC's deregulation of special access under Pricing Flexibility a "regulatory and marketplace success story."[2] Unfortunately, the facts state otherwise.

One need not look too far to see the power of the BOCs' control over special access. SBC's and Verizon's power and influence over the special access market is exemplified by the fact that they eliminated dissention from the two biggest advocates for changes to the special access regime. AT&T and MCI appear to have been silenced by their monopoly suitors. It was AT&T who initiated this docket, yet now AT&T seeks minimal changes to the current rules. Worse yet, MCI, who just last year told the FCC that the BOCs have "exploit[ed] their market power in MSAs where they have been granted pricing flexibility,"[3] did not even file comments on the FCC's NPRM. One can only conclude that the pending mega-mergers between SBC-AT&T and Verizon-MCI caused the two biggest purchasers of BOC special access services to revise their advocacy on the need for special access reform.

2 Comments of Verizon, WC Docket No. 05-25 (June 13, 2005) at 1.

3 Comments of MCI, WC Docket No. 04-313 (October 4, 2004) ("MCI TRR Comments") at 157.

Atmospherics aside, the pending mega-mergers, if approved, will only worsen the current problem of high special access rates. If the BOCs are charging excessive rates today while competing against large facilities-providers like AT&T and MCI, rates will only rise when the two competitors are absorbed into SBC and Verizon. In the past, AT&T and MCI have both argued that the BOCs are abusing their market power with unjust and unreasonable special access rates.[4] There is no reason to believe that special access rates will go down with BOC increased market power.

Verizon argues that there is robust competition for special access services because CLECs have either built their own fiber networks or are buying unbundled network elements and special access services to compete against the BOCs. According to Verizon, because CLECs are buying special access services from Verizon, rates must be reasonable. Verizon's simplistic arguments are misleading. It is important to recognize that competition was just beginning to take root in some major metropolitan areas, but the source of much of that competition was AT&T and MCI, who will most certainly pull out of the wholesale local access market due to their mergers with SBC and Verizon. While other CLECs have built fiber networks in certain places, no CLEC has a ubiquitous competitive presence in any BOC region. Moreover, most competitive fiber is transport and not dedicated loop facilities like Verizon implies. Finally, because there is a scarcity of competitive supply and, as discussed below the BOCs often make it extremely difficult for CLECs to purchase unbundled network elements, CLECs often have no choice but to purchase special access services from the BOCs.

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4 *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, Petition for Rulemaking (filed October 15, 2002) at 1; MCI TRR Comments at 154-162.

XO has constructed fiber optic transport facilities in places where it makes economic sense to do so. Where XO lacks the traffic volumes required to construct its own interoffice facilities, XO must purchase interoffice transport facilities from other carriers. XO is constantly looking for opportunities to purchase transport from other CLECs, but no CLEC has constructed facilities on all interoffice routes in the country. Even where CLECs have in fact self-deployed interoffice transmission facilities, it does not mean that they have the capacity to offer access to their networks to competing CLECs.[5] More times than not, the only option CLECs have is to purchase transport from the BOCs.

Additionally, while CLECs, like XO, have built their own transport facilities in certain areas, very few CLECs have constructed loop facilities. Construction of loop facilities is more times than not uneconomic due to the costs of construction and the time associated with doing so. First, to make investment economic, capacity demand at a particular location must warrant deployment of at least three DS3s.[6] Second, before a CLEC can construct its own loop facility, it must negotiate rights of way, secure municipal permits and obtain building entrance agreements. Next, the CLEC must install conduit and pull fiber between the building and the competitor's nearest outside plant facility. Finally, the CLEC must then lease space within the building to place an OC-3 or higher bandwidth terminal in the building. This costly and lengthy process forces carriers to lease facilities from the incumbent who has long since secured access to the building.

Verizon claims that since CLECs buy special access today to deliver services, the rates must be reasonable. To the extent that XO purchases DS-1 and DS-3 circuits from Verizon and

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5 Declaration of Wil Tirado, Attachment B to Loop and Transport Coalition Comments, WC Docket No. 04-313 (October 4, 2005) ("Tirado Declaration") at ¶¶ 36-37.

6 Tirado Declaration at ¶ 20.

the other BOCs to serve its local end user customers, XO does so primarily through the use of UNEs, not special access. Indeed, the majority of the DS-1 circuits purchased by XO from the ILECs are UNEs, not special access.

Data included in Verizon's comments purports to show that XO purchases more special access than UNEs. Exhibit 36 to the Declaration of Quintin Lew (Attachment D to Verizon's Comments) incorrectly states XO's ratio of DS1 special access loops to UNE loops. The Lew Declaration is based on March 2004 data, which is outdated. XO's records indicate that a **minority** of DS-1 facilities purchased from Verizon today are special access circuits. Hence, the Lew Declaration exaggerates XO's reliance on special access in an attempt to demonstrate that competitors are using Verizon's special access services in competition with Verizon. To be clear, the majority of XO's DS1 loops leased from Verizon are UNE circuits, not special access as Verizon claims.

While XO does purchase special access circuits from Verizon, it does so primarily because it has no other choice. XO would rather purchase high capacity circuits from other competitors, but as discussed above, that is rarely an option. XO would also prefer to purchase such circuits as UNEs but again that is not always an option. It is worth explaining why XO has been forced to buy special access from the ILECs for use as local loops.[7] As detailed in the Tirado Declaration submitted in the *Triennial Review Remand* proceeding, XO has been forced to order special access instead of UNEs due to: 1) the ILECs' refusal to "construct" facilities; 2) until recently, the lack of clarity on the FCC's UNE combination rules (EELs) and commingling prohibitions; 3) ILEC delays in converting special access circuits to UNEs; and 4) the FCC's eligibility rules.

7 Tirado Declaration at ¶¶ 45-48.

In December 2004, XO submitted a letter to the FCC explaining that where XO has ordered special access circuits from the ILECs, it normally has done so unwillingly as a result of ILEC refusals to timely honor XO's request for UNE circuits at those locations.[8] XO orders DS-1 special access circuits instead of UNEs only when strong-armed into doing so by the ILECs to ensure that customers are not lost. XO is rarely a willing purchaser of special access and most often is forced to order special access circuits because the ILECs refuse to "construct" facilities. Verizon in particular has adopted this anti-competitive "no facilities available" policy as a means of compelling CLECs to order special access instead of UNEs. Thus, the level of use of special access by XO is hardly evidence that special access is priced competitively at just and reasonable rates. Nor is it proof that there can be robust competition solely through reliance on special access.

Moreover, attempts to convert existing special access circuits to UNEs have been met with stubborn (and unlawful) resistance by the ILECs. The ILECs go to great lengths to avoid converting special access circuits to DS-1 loop UNEs. In XO's experience, the ILECs simply are not fulfilling requests to convert special access circuits to UNEs, prolonging the timeframe for completing conversion requests, or attempting to charge astronomical rates for doing so. Verizon, for example, in the past has refused to convert existing special access circuits until XO submits separate "disconnect" and "new" orders for each of the circuits XO wants converted to UNEs.[9] Moreover, Verizon slow rolls the conversion process by claiming it can only process minimal circuits per LATA per day.[10] BellSouth is no better. BellSouth delayed XO's circuit

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8 Ex Parte Letter from Brad Mutschelknaus, on behalf of XO, to Marlene Dortch, FCC, WC Docket No. 04-313 (December 7, 2004) ("XO Special Access Ex Parte").

9 XO Special Access Ex Parte at 3.

10 *Id.*

conversion (non-EEL) requests for over three years, insisting on full nonrecurring charges for disconnection and reconnection of each circuit plus an exorbitant management fee.[11]

XO would prefer to order UNEs over special access everywhere but due to ILEC practices, XO often has no other option but to purchase special access. Just because XO purchases special access at the current high rates does not mean that the rates are reasonable. If XO were compelled to order all of its DS-1 and DS-3 loop facilities as special access, its existing integrated voice and data services offered to small and medium-sized customers would be uneconomic, and its ability to offer service to off-net customers would end.[12]

No one knows more about the lack of competitive supply for special access connectivity than the Ad Hoc Telecommunications Users Committee. As large business users of telecommunications services, Ad Hoc has repeatedly alerted the FCC to the lack of competition in the special access marketplace.[13] Ad Hoc has filed a wealth of factual evidence and economic analyses that demonstrate the lack of competitive alternatives to BOC special access services.[14] The ILECs remain the sole source of special access connectivity to 98% of business premises nationwide.[15]

As Ad Hoc points out, "if users confronted actual competitive choices for BOC switched and special access services, or if the BOCs believed that such competitive alternatives could materialize, they would be lowering their prices in purportedly competitive markets, and their

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11 *Id.* at 4.

12 Tirado Declaration at ¶ 52.

13 Comments of the Ad Hoc Telecommunications Users Committee, WC Docket No. 05-25 (June 13, 2005) ("Ad Hoc Comments") at 7.

14 Ad Hoc Comments at footnote 5.

15 Ad Hoc Comments at 14.

earnings would be moving down toward competitive levels. But that is not happening."[16] The price increases that have occurred under pricing flexibility are "substantial and sustained."[17] Moreover, the average rate of return for special access for the four RBOCs was 53.7% for 2004.[18] Clearly, there is a problem.

B. Pricing Flexibility Has Not Produced Lower Special Access Rates

All four BOCs have increased prices for special access circuits in every region for which they have received pricing flexibility.[19] When it adopted pricing flexibility, the FCC could not have intended for prices to increase and remain high. That is exactly what has happened. The BOCs are not using pricing flexibility to respond to market forces. Rather, they are using it as a means to increase their profits and squeeze out competitors.

Verizon, BellSouth, Qwest and USTA attempt to gloss over the fact that the BOCs are realizing high rates of return on special access services. They argue that ARMIS is not a reliable measure of special access rate of return levels. Anticipating such an argument, the Ad Hoc Telecommunications Users Committee dismisses claims that ARMIS reports cannot be relied on in this context.[20] As Ad Hoc correctly points out, the ILECs have relied on ARMIS in their constant efforts to defeat UNE pricing rules so they cannot now abandon use of ARMIS because the results do not suit their needs.[21]

In an attempt to steer the Commission away from review of BOC rates of return on special access services, Verizon argues that special access pricing has declined and there is

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16 Ad Hoc Comments at 16.

17 Ad Hoc Comments at 17-18.

18 Ad Hoc Comments at iii.

19 Ad Hoc Comments at 18-21.

20 At Hoc Comments at 28-31.

21 Ad Hoc Comments at 29 and footnote 54.

robust competition in the enterprise market. This same issue was debated less than a year ago in the *Triennial Review Remand* docket. In the *Triennial Review Remand* docket, Verizon filed two Declarations from Dr. William Taylor and Eric Bruno on special access pricing trends and competition in the enterprise market that were critiqued by Dr. Michael Pelcovits and Chris Frentrup of the consulting firm MiCRA. Over twenty CLECs, including XO, AT&T and MCI, submitted a Declaration from MiCRA that concludes that Dr. Taylor and Mr. Bruno's analysis is erroneous.[22] MiCRA states:

> We have demonstrated that the ILECs' claims regarding the changes in their special access prices are erroneous. Specifically, ILEC claims that competition has compelled them to lower their special access rates are false, and the Commission cannot rely on market forces in the future to restrain the ILECs' ability to take anti-competitive actions against CLECs. The ILECs will have the incentives and ability to use the pricing flexibility that they have for their special access services to engage in price squeezes and exclusionary pricing against the CLECs.[23]

In this docket, Verizon filed similar Declarations from Dr. William Taylor and Eric Bruno on the same issues. These Declarations suffer from the same deficiencies as their previous submissions. For example, here Dr. Taylor attempts to show that there have been rate decreases under the pricing flexibility regime.[24] Dr. Taylor attempted to make the same case last year but MiCRA uncovered "methodological flaws that render it useless for making such a demonstration."[25]

The existing special access pricing flexibility regime is fatally flawed, and there is no reason to believe that with industry consolidation and the elimination of UNEs in certain areas

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22 Reply Declaration of Michael Pelcovits and Chris Frentrup, appended to Ex Parte Letter from Thomas Cohen, KDW Group, to Marlene Dortch, FCC, WC Docket No. 04-313 (October 19, 2004) ("MiCRA Reply Declaration").

23 MiCRA Reply Declaration at ¶ 29.

24 Verizon Comments at 7.

25 MiCRA Reply Declaration at ¶ 5.

that special access pricing will be regulated by market forces. As demonstrated by XO and others, pricing flexibility has resulted in special access rates that are unjust, unreasonable, discriminatory and not in the public interest.

Now more than ever, Commission intervention is necessary to ensure that special access rates, terms and conditions are just and reasonable. The FCC should eliminate rules that attempt to gauge whether competition exists in a given market for special access services. As XO and others explained in their initial comments, revamping or eliminating the existing pricing flexibility triggers will not address the current situation. Despite the BOCs' claims to the contrary, competition has not developed for special access services.

XO supports proposals advocated by the Ad Hoc Users Group, CompTel and other CLECs that the FCC should revoke pricing flexibility and reinitialize price caps to levels designed to produce normal, not monopoly returns. Reducing special access charges for services subject to Phase II pricing flexibility to rates that would produce an 11.25% rate of return is necessary to bring the current special access rates in line with what rates would be in a competitive market. As XO explained in its initial comments, XO does not contest deregulation where it is appropriate. In this context, however, deregulation remains inappropriate. Until the BOCs can demonstrate that the market is sufficiently competitive to keep prices and profits in check, there must be Commission regulation of special access pricing.

IV. CONCLUSION

For the foregoing reasons, the Commission should abolish the special access pricing flexibility rules.

Respectfully submitted,

XO Communications, Inc.

By: ______________________

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